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Nos. 90-1361, 90-1484

In The
Supreme Court of the United States
October Term, 1991

Holywell Corporation, *et al.*,
Petitioners
v.
Fred Stanton Smith, *et al.*

United States of America,
Petitioner
v.
Fred Stanton Smith, *et al.*

On Writs of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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BRIEF FOR PETITIONERS HOLYWELL CORPORATION, ET AL.

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QUESTION PRESENTED

Is a trustee appointed by a bankruptcy court as part of a confirmed plan of reorganization to effect a liquidation of a debtor's estate required to file federal income tax returns and to pay federal income taxes?

PARTIES TO THE PROCEEDINGS BELOW AND STATEMENT PURSUANT TO RULE 29.1

1. Petitioners in No. 1361 are Holywell Corporation, Miami Center Limited Partnership, Miami Center Corporation, Chopin Associates and Theodore B. Gould. Holywell Corporation and Miami Center Corporation state that they have no parent companies, subsidiaries or affiliates to list pursuant to Rule 29.1. Petitioners Miami Center Limited Partnership, Chopin Associates and Theodore B. Gould are not corporations.

2. The United States of America is the petitioner in No. 1484.

3. Respondents are Fred Stanton Smith, The Bank of New York and Shutts & Bowen.

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BRIEF FOR PETITIONERS HOLYWELL CORPORATION, ET AL.

OPINIONS OF OTHER COURTS

The majority and dissenting opinions of the court of appeals (Pet. App. 1a-16a) are reported at 911 F.2d 1539 (11th Cir. 1990). The court of appeals' denial of rehearing and rehearing in banc (Pet. App. 40a-41a) is unreported. The opinion of the district court (Pet. App. 17a-27a) is unreported. The opinion of the bankruptcy court (Pet. App. 28a-37a) is reported at 85 Bankr. 898 (Bankr. S.D. Fla. 1988).

JURISDICTION

The judgment of the court of appeals was entered on September 18, 1990 (Pet. App. 1a), and a suggestion of rehearing in banc (which is treated by the Eleventh Circuit as a petition for rehearing as well, 11th Cir. R. 35-6) was denied on December 21, 1990 (Pet. App. 40a-41a). Petitions for certiorari were filed by Holywell Corporation, *et al.*, on February 28, 1991, and by the United States on March 20, 1991. On May 28, 1991, the Court granted the petitions and consolidated the cases. The jurisdiction of this Court rests on 28 U.S.C. § 1254(1) (1988).

STATEMENT

1. *The Bankruptcy Cases.*—In August 1984 the five related petitioners in No. 1361, Holywell Corporation ("Holywell"), Miami Center Limited Partnership ("MCLP"), Miami Center Corporation ("MCC"), Chopin Associates and Theodore B. Gould (collectively, the "debtors"), each filed petitions for reorganization under Chapter 11 of the Bankruptcy Code. Petitioner MCLP developed the Miami Center, a hotel, office and retail complex in Miami, Florida. Chopin Associates owned the land upon which the Miami Center was built. MCC and Gould were general partners in MCLP. Holywell was a limited partner. Holywell's and Gould's principal assets prior to the filing of the bankruptcy petitions consisted

of (1) their equity in the Miami Center; and (2) equity in properties located in the Washington, D.C., area.[1]

Respondent The Bank of New York ("BNY" or the "Bank") was the lead mortgage lender to MCLP. The debtors filed their petitions after the Bank had commenced foreclosure proceedings in Florida state court.

2. *The Bank's Plan.*—In February 1985, each of the debtors and the Bank proposed plans of reorganization. The debtors' plans contemplated the sale of the Miami Center—and, as a consequence, the payment of some $22.2 million in federal income taxes on the debtors' capital gains from the sale, as is required of any bankruptcy reorganization plan by 11 U.S.C. § 1129(d).[2]

The Bank's Plan also contemplated the sale of the Miami Center; the Bank's Plan and Disclosure Statement, however, were silent on the subject of federal income taxes. The Bank has now admitted to this Court

[1] These "Washington properties" were sold during the first few months of the bankruptcy proceedings in 1984. By February 1985, Holywell had approximately $15.1 million in cash available to pay its liabilities of about $3.3 million, not including federal and state income taxes or its guarantees of the several construction mortgages given by MCLP to The Bank of New York. Pro Forma Balance Sheet and Liquidation Analysis Exs. C & E to Disclosure Statement and Plan of Reorganization of Holywell Corp. (Bankr. C.P., No. 377). In addition, Holywell's wholly-owned subsidiaries—which did not file bankruptcy petitions—had at least an additional $13.6 million in cash (before taxes) available for distribution as dividends to Holywell. *Id.* Because of Holywell's guarantees on MCLP's mortgages (which had been called), it was insolvent.

[2] Liquidation Analyses, Exs. E to Disclosure Statements and Plans of Reorganization of Debtors Holywell Corporation and Theodore B. Gould (filed February 15, 1985) (Bankr. C.P. Nos. 377, 381). Because Holywell had cash available to it (either of its own or of its non-debtor subsidiaries in excess of their liabilities) in a substantial amount, it could have paid its capital gains taxes, which would have been a first-priority administrative expense. The taxable gain realized by MCLP, a partnership, on disposition of the Miami Center, was taxable to its partners, including Gould and Holywell. I.R.C. §§ 701, *et seq.*

that its (undisclosed) intent was that the federal capital gains taxes would not be paid under its Plan. *See* BNY Br. in Opp. 9-10, 16, 27. Thus, unburdened by the millions of dollars of federal income tax liability that should have been paid, the Bank was able to treat itself in an extraordinarily generous fashion in its "cram-down" plan.[3] The Bank's Plan allowed the Bank to recover 100 cents on the dollar for all principal and all interest, including postpetition interest, even though the Bank was, according to the bankruptcy court that confirmed the Plan, "undersecured" and facing "a substantial loss." 54 Bankr. at 41, 43.[4]

The Bank's device for reaching this anomalous result was (1) substantive consolidation of the debtors' estates (*see* p. 4 n.5, *infra*) and (2) a heretofore unheard of loophole in the tax and bankruptcy laws: the appointment, as part of the Bank's chapter 11 plan of reorganization, of a trustee who would take possession of all the debtors' assets and sell them—without (we have now been told) paying federal or state taxes. Of course, the trustee's proposed immunity from paying taxes of any kind

[3] According to counsel for the Bank, a "cram-down" plan is one adopted over the objections of parties to the bankruptcy proceeding. F. Carter, "Orchestrating and Implementing a Successful Creditors' Plan," *The Bankruptcy Strategist* 3-4 (February 1987).

[4] This portion of the Bank's Plan therefore violated section 506 of the Bankruptcy Code, which provides that an undersecured creditor may not recover postpetition interest. *United Sav. Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 372-73 (1988). The trustee brought an adversary proceeding to obtain an adjudication resolving this anomaly, and the bankruptcy judge entered a one-page "judgment" (without any findings of fact or conclusions of law) reversing the decision that the Bank was undersecured. However, the district court vacated that judgment as "moot" under the bankruptcy "mootness doctrine," concluding that "the validity of the credit [for postpetition interest] under Section 506(b) as a matter of law must remain unanswered." The higher reviewing courts did not intervene. *In re Holywell Corp.*, No. 88-151-CIV (S.D. Fla. July 21, 1988), *appeal dismissed*, 923 F.2d 865 (11th Cir.), *cert. denied*, 111 S. Ct. 2259 (1991).

and from the operation of the priority statutes in favor of the United States was not disclosed by the Bank.[5]

On April 29, 1985, the bankruptcy court held a hearing at which it deferred consideration of the plans of reorganization. On July 18, 1985, the bankruptcy court held a hearing on the "substantive consolidation" portion of the Bank's Plan (*see* n.5, *supra*). Ruling from the bench, the bankruptcy judge approved the "modified form" of substantive consolidation. He stated: "I readily concede that I am a babe in the woods [in the tax area] and haven't the foggiest notion of what the tax consequences would be on the particular decision that we are talking about right at the moment." [6]

[5] In addition to the use of a "liquidating trustee," the Bank's Plan employed several other interesting devices. First, it required the subordination of a $14 million priority claim by a joint venture between petitioner Gould and Olympia & York Florida Equity Corporation, a company unaffiliated with the debtors. As a result of this "subordination," the Order confirming the Bank's Plan was reversed because it "discriminate[d] unfairly" and was not "fair and equitable" in violation of 11 U.S.C. § 1129(b). *In re Holywell Corp.*, 913 F.2d 873, 879-81 (11th Cir. 1990). In addition, the Bank's Plan called for "substantive consolidation" of the debtors' estates. "Substantive consolidation has no express statutory basis but is a product of judicial gloss. [It] usually results in, *inter alia*, pooling the assets of, and claims against, the two entities; [and] satisfying liabilities from the resultant common fund . . . ." *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988). Here, because substantive consolidation would have unfairly prejudiced the creditors of Holywell (which had substantial cash, *see* p. 2 n.1, *supra*), the Bank stipulated to—and the bankruptcy court approved —a "modified form" of substantive consolidation that called for the payment of Holywell's creditors out of Holywell's assets before Holywell's assets could be used to pay any claims against any of the other debtors. J.A. 55. Thus, under this modified form of substantive consolidation, the Government's tax claims against Holywell and its subsidiaries should have been paid before Holywell's funds could have been made available to creditors of the other debtors. *See also Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) ("all questions of fraudulent conveyance aside, creditors of the corporation normally would be entitled to satisfy their claims out of corporate assets prior to any participation by the creditors of the stockholder.").

The bankruptcy judge never satisfied himself that the Plan adequately provided for the payment of the taxes. Nonetheless (and without further hearing), on August 8, 1985, he confirmed the Bank's Plan. 54 Bankr. at 42-43. Pursuant to the Plan, the bankruptcy court appointed respondent Fred Stanton Smith as trustee. Smith accepted the appointment, declared that he satisfied the requirements for trustees under 11 U.S.C. §§ 321 and 101(13), and posted a one million dollar fidelity bond in favor of the United States. And on October 10, 1985, Smith sold the Miami Center to the Bank and its colenders.

Concerned about his potential personal liability because of, *inter alia*, the Bank's failure to provide for the payment of taxes, the trustee asked for and received from the Bank a personal indemnification. J.A. 169, 170-71.

The Plan provided the trustee with a full panoply of powers over the debtors' properties. He had the power to employ attorneys, accountants and, interestingly, despite the Bank's intentions, "tax specialists"; to prosecute, defend, settle or discontinue any disputes or litigation of the debtors; and to waive any of their rights. Pet. App. 45a. He had the power to sell, manage, operate, lease, mortgage, or otherwise "release, convey or assign any right, title or interest in or about the Trust Property." Pet. App. 44a. He had the right to "[d]eal with the Trust Property or any part or parts thereof in all other ways as would be lawful for any person owning the same to deal therewith, whether similar to or different from the ways above specified, at any time or times hereafter." Pet. App. 45a-46a. The only restriction on the trustee's power was that he could "[t]ake no action that would change the business of any of the Debtors . . . ." Pet. App. 46a.

[6] Transcript (July 18, 1985) (BNY Br. in Opp. B-49).

If that were not enough, the Plan went on to make the total control by the trustee crystal clear: "as to any party dealing with the Trustee in any manner whatsoever in relation to the Trust Property, the power of the Trustee to act or otherwise deal with said properties shall be absolute." J.A. 44.

Although the Bank's Plan did not expressly provide for the payment of federal income taxes, it did not openly purport to excuse the trustee from the obligation to file federal income tax returns or to pay federal taxes.[7]

The tax liabilities in question arise not only from the taxable gain realized when the trustee sold the Miami Center, but also from the trustee's post-confirmation earnings over the last five years, consisting of interest and other taxable receipts now totaling more than $18.4 million.[8]

3. *The Implementation of the Bank's Plan (Despite Its Nullification)*.—Two separate appeals of the confirmation order were taken. First, the debtors appealed. Second, the Miami Center Joint Venture ("MCJV"), a

[7] Presumably in light of the plain statutory language requiring trustees, fiduciaries, assignees and court officers of all descriptions to pay federal taxes (*see* pp. 12-14, 17-30, *infra*)—and the Bank's failure to disclose its intention that this trustee not abide by those statutes—the United States did not object to the Plan. In addition, the United States was not required to, and did not, file a proof of claim prior to the January 1985 "bar date" for the taxes that eventually would be due on the sale of the Miami Center. No income would be recognized until the actual sale, which took place in October 1985—months after the Plan was confirmed—and even then the large bulk of the taxes would not be due until October 15, 1986, when Holywell's federal income tax return for the tax year ending July 31, 1986 was due to be filed by the trustee.

[8] Although the trustee has never filed federal income tax returns, the Internal Revenue Service recently conducted an audit of Holywell's and Gould's estates. According to the agent's preliminary findings, the liabilities of the Holywell (for the tax year ending July 31, 1986) and Gould estates (for the tax year ending December 31, 1985), including penalties and interest, total more than $35 million. No audit of the later years has yet been completed.

partnership between Gould and Olympia & York Florida Equity Corporation, also appealed. The two separate appeals were heard by different district judges and, on further appeals, by two separate panels of the court of appeals.

In the debtors' appeal, the district court affirmed the confirmation order. However, the court of appeals held that the debtors' failure to post a fifty million dollar bond precluded *any* appellate review of the confirmation order, under the Eleventh Circuit's expansive common law version of the bankruptcy "mootness doctrine." The court of appeals therefore *vacated* the district court order affirming the confirmation of the Plan. *Miami Center Limited Partnership* v. *Bank of New York*, 838 F.2d 1547, 1558 (11th Cir.), *cert. denied*, 488 U.S. 823 (1988).

In MCJV's appeal, the district court *reversed* the confirmation order. *Olympia & York Fla. Equity Corp., et al.* v. *Bank of New York*, No. 85-3230 (S.D. Fla. March 24, 1987), *aff'd sub nom. In re Holywell Corp.*, 913 F.2d 873, 879-81 (11th Cir. 1990). The "mootness doctrine" was not held applicable to this appeal.[9]

4. *This Proceeding—The Bankruptcy Court and the District Court*.—Notwithstanding his statutory duties to do so, the trustee refused to file federal income tax returns or pay federal taxes. Instead, on December 28, 1987, he commenced an adversary proceeding in the bankruptcy court against the debtors and the United States, seeking a declaration that he was not required to file income tax returns and pay federal income taxes in-

[9] Therefore it appears quite clear that the Order confirming the Plan has now been unequivocally reversed, although it appears that the liquidation of the debtors' business affairs and property has de facto continued to be conducted under the Plan by the Trustee. The bankruptcy court has required the Bank to pay a $22 million judgment to MCJV under the Eleventh Circuit's mandate imposing that liability upon the Bank for wrongfully subordinating MCJV's interest in the proceeds from the sale of MCJV's property.

curred. Adversary Complaint ¶ 18 (Smith Br. in Opp. 6a). In the alternative, the trustee sought a declaration that the Bank should pay any such taxes because: (1) the Bank, presumably fraudulently, proposed the Plan without providing the means to pay the taxes; (2) the Bank, presumably fraudulently, failed to disclose the obligation to pay the taxes; and (3) the Bank had agreed to indemnify the trustee. *Id.*

The bankruptcy judge agreed that the trustee was not required to pay the taxes and asked counsel for the trustee to draft the opinion.[10] The primary rationale put forward in support of this unprecedented decision absolving the trustee of liability to pay federal income taxes was the somewhat circular proposition that "the liquidating trustee, being a creature of a contract, is a contract trustee." Pet. App. 32a; 85 Bankr. at 901. No source of law indicating any special attributes of, or special treatment for, a "contract trustee" was identified. Instead, the opinion simply stated "[i]f Congress had intended to hold a . . . contract trustee liable to file a tax return and to pay taxes, it could have explicitly provided for this . . . ."

[10] We are unaware whether the bankruptcy judge adopted the trustee's proposed opinion *verbatim* because counsel for the trustee submitted it to the bankruptcy judge *ex parte* and has thus far declined to provide petitioners with any information about his draft opinion or any modifications thereto. However, the bankruptcy judge in this case has made a practice of adopting *in toto* and *verbatim* the findings of fact and conclusions of law drafted by the victorious party. *E.g.*, Order Granting Bank of New York's Motion for Issuance of Trustee's Certificate (May 2, 1991) (Bankr. C.P. No. 2237), *stayed pending appeal*, *In re Holywell Corp. (United States* v. *Bank of New York)*, No. 91-953-CIV-RYSKAMP (S.D. Fla. May 16, 1991). In this regard, he has expanded upon the practice of his predecessor. *See, e.g.*, *Miami Center Ltd. Partnership* v. *Bank of New York*, 838 F.2d at 1551 n.4; *Olympia & York Fla. Equity Corp. & Miami Center Joint Venture* v. *Bank of New York*, No. 85-3230-CIV-ATKINS, slip op. at n.3 (S.D. Fla. March 24, 1987). At least the first bankruptcy judge—who was recused from the case (after he confirmed the Bank's Plan) for bias against the debtors—solicited proposed findings from all parties, a practice that Judge Weaver, the current bankruptcy judge, apparently deems unnecessary.

Pet. App. 33a; 85 Bankr. at 901.[11] The district court affirmed in an unreported decision that adopted the same reasoning. Pet. App. 23a-24a.

Neither court addressed the trustee's alternative request for a declaration concerning the Bank's responsibilities, although the trustee continues to assert that in the event he is liable to pay the federal income taxes the Bank should be required to pay them. Indeed, this has become imperative for the trustee, since he has allowed the Bank to take over $27 million in postpetition interest on its "undersecured" claim and, in addition, has distributed over $30 million from the trust to creditors subordinate in right of payment to the United States without reserving sufficient funds for the payment of federal or state income taxes.

5. *The Court of Appeals' Decision*.—The United States and the debtors appealed. The court of appeals, in a split decision, affirmed. The majority wrote that "[b]y its terms, section 6012 refers only to trustees who are appointed under *Chapter* 11 of the Bankruptcy Code." Pet. App. 11a; 911 F.2d at 1545 (emphasis added). From this, the majority concluded, without discussion or citation, that section 6012 "was not intended to apply to a broad range of individuals without regard to the functions which they perform." Pet. App. 11a; 911 F.2d at 1545.

The majority did not discuss the other statutes that require a trustee or other fiduciary of an insolvent estate to pay federal taxes. 28 U.S.C. § 960; 31 U.S.C. § 3713. It relied exclusively on a case decided by a bankruptcy

[11] The opinion's conclusion that this is a case of the dog that did not bark in the night pointed to no indication (and we have found none) that Congress had ever heard of the term "contract trustee," or if so that it attached any significance to it, or felt that such a trustee was to be treated differently from any other trustee. Congress had passed a number of statutes exhibiting its unmistakable command and intention to subject *all* fiduciaries (including "trustees") dealing with insolvent estates to the payment of taxes. *See* pp. 12-14, 17-30, *infra*.

court under the now-repealed Bankruptcy Act of 1898.[12] *In re Alan Wood Steel Co.*, 7 Bankr. 697 (Bankr. E.D. Pa. 1980). The *Alan Wood Steel* case involved a disbursing agent under that Act, empowered by statute only to "' "distribute, subject to the control of the court, the consideration . . . deposited by the debtor." ' "[13] The majority's characterization of the trustee in this case as a "disbursing agent" or "contract trustee," Judge Cox in dissent wrote, "denies the reality of [the trustee's] rights, duties and obligations under the Plan. A mere label does not magically transform the liquidation trustee into something he is not. In fact, his job description squarely fits within the Internal Revenue Code description of a 'fiduciary.'" Pet. App. 14a-15a; 911 F.2d at 1547.

The majority of the court felt compelled to answer the obvious question: if the trustee was not going to file tax returns and pay taxes on the gains on the property and the income on the cash in his hands, who was? It said:

> Our conclusion does not leave the government without the ability to collect taxes on the post-confirmation sale of property. It simply means that the reorganized debtor, not the liquidating trustee is responsible for such taxes.

Pet. App. 9a-10a; 911 F.2d at 1545.

The court did not furnish any authority for this proposition; it did not define who the "reorganized debtor" was; and it did not indicate who was to pay the taxes on the interest earned over the years upon the funds in the trustee's hands, invested as they were in certificates of deposit and other income-producing investments; but presumably the "reorganized debtor" was to do this too.

Finally, the court decided that the allegation of fraud contained in the trustee's complaint "is an attempt to

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[12] Pub. L. 55-171, 30 Stat. 544, *amended by* Chandler Act, Pub. L. 75-696, 52 Stat. 840 (1938), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. 95-598, § 401(a), 92 Stat. 2549, 2682.

[13] Pet. App. 15a; 911 F.2d at 1547 (quoting 7 Bankr. at 701, quoting, in turn, former 11 U.S.C. § 737(1) (1976)).

modify or alter the Plan and is therefore barred under the mootness doctrine." Pet. App. 6a; 911 F.2d at 1543. The court relied on its earlier decision dismissing the debtors' appeal of the confirmation order. *Miami Center Limited Partnership* v. *Bank of New York*, 838 F.2d at 1553. However, the court refused to apply the "mootness doctrine" to the question whether the trustee was required by statute to pay federal income taxes, finding that raising this question was "not an attempt to modify or alter the Plan." Pet. App. 7a; 911 F.2d 1544.

6. *Subsequent Developments.*—Since the decision of the court of appeals, the trustee has continued to operate under bankruptcy court supervision. On January 31, 1991, he obtained bankruptcy court "approval" to disburse millions of dollars from the trust.[14] Since then, he has also, among other things, sought and obtained bankruptcy court approval purporting to authorize him to:

—employ "special counsel" before this Court;

—pay out of the trust funds his counsel's fees incurred in fighting his duty to pay federal taxes;

—consummate a settlement he reached requiring the payment of several million dollars in property taxes to Dade County, Florida; and

—compromise other private litigation.

The trustee today has in his possession approximately $25 million in trust funds, of which about $18 million represents income received on the funds in his hands or otherwise on behalf of the estates in his custody.[15]

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[14] Justice Kennedy denied the debtors' application for reinstatement of the court of appeals' stay and injunction, which had prevented the trustee from disbursing funds from the trust during the pendency of the appeal. No. A-546 (January 22, 1991). The stay and injunction automatically terminated upon issuance of the court of appeals' mandate. The United States did not seek reinstatement of the stay and injunction.

[15] Except for the United States, all the debtors' third-party creditors who filed claims in the bankruptcy court have been paid 100 cents on the dollar for such claims.

SUMMARY OF ARGUMENT

The court of appeals' decision presents a misapplication of a matrix of federal statutes designed to insure that federal taxes are paid by the fiduciaries of insolvent business entities and individuals. By holding the trustee in this case exempt from those statutes, the court of appeals has created a tax loophole available in a broad spectrum of cases. Its decision is contrary to the plain language of the statutes, to the purposes of the tax and bankruptcy laws, and to this Court's decisions.

Dating from the First Congress, the clear and consistent purpose of federal statutory law has been to make certain that all assignees, trustees, receivers, and fiduciaries of insolvent estates (whether or not appointed by a court) assume and discharge a duty to pay federal taxes on the operations or income of their estates. Today, there are several statutes on the books to carry out that long-standing national policy. 28 U.S.C. § 960; 31 U.S.C. § 3713; I.R.C. § 6012(b). The statutes' sweeping language is designed to cover such fiduciaries regardless of the mechanism of their appointment. Indeed, this Court has confirmed in several cases involving bankruptcy liquidations that each of these statutes requires the payment of federal taxes by a trustee appointed by a bankruptcy court for the purpose of liquidating a debtor's assets. The statutes are single-minded and, to an extent, redundant because they are the embodiment of Congressional commands at different dates; but they are consistent and do not leave open the loophole contended for.

First, section 960 of the Judicial Code subjects "any officers and agents conducting any business under authority of a United States court" to "all Federal, State and local taxes applicable" to the business. This Court recently held that section 960 requires a bankruptcy trustee to pay state taxes "on the liquidation process." *California State Bd. of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844, 853 (1989). Other decisions of this Court confirm that section 960's plain language applies

to a broad spectrum of court officers. Of course, section 960 applies uniformly to "all Federal, State and local taxes." The point has been well summarized:

> In [*Sierra Summit*, the Court] concluded that Sec. 960 evinces Congress's intention that a business conducted under court order, whether in bankruptcy or state-court receivership, be subject to the same taxes it would have been had it been in the possession of the owner . . . . [including taxes on] [p]roperty purchased at a bankruptcy liquidation sale . . . .

F. Carter & J. Anderson, "Sales & Use Taxes Can Be Imposed on Liquidation of Bankrupt's Estate," *The Bankruptcy Strategist* 3, 6 (July 1989).

Second, the absolute priority statute, derived from legislation enacted by the First Congress and on the statute books in substantially its present form since the early nineteenth century, requires that the claims of the United States with respect to "a person indebted to the Government" who is insolvent and is divested of his property in various enumerated ways—including through a bankruptcy process—must be paid "first" by the insolvent person's representative. 31 U.S.C. § 3713(a). The statute has been given a consistent and broad interpretation through over a century and a half of construction by this Court. To assure compliance, the statute (in a provision dating from 1799) provides that "a representative" of the insolvent paying any part of a debt before the claim of the United States is personally liable, to the extent of that payment, for the unpaid claims of the United States.

In *King* v. *United States*, 379 U.S. 329, 338 (1964), this Court held that the then-effective version of section 3713 applied even to a disbursing agent under section 337(1) of the former Bankruptcy Act. The Court rejected the disbursing agent's argument that he was not liable for the payment of taxes because he performed "only the ministerial function of paying out the deposited funds in conformity with the court's orders." *Id.*

Third, section 6012(b)(3) of the Internal Revenue Code provides that "[i]n a case where a receiver, trustee in a case under title 11 of the United States Code, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation," the fiduciary must file federal tax returns. Section 6012(b)(4) requires the same of a "fiduciary" (which is defined by section 7701 to include a "trustee") of "an estate, a trust, or an estate of an individual under Chapter 7 or 11 of title 11." Section 6151(a) requires the person making the return to pay the tax. The plain, sweeping language of section 6012(b) also brings the trustee within the statute's ambit, requiring him to file federal tax returns and pay the taxes. In *Nicholas* v. *United States*, 384 U.S. 678, 693-94 & n.27 (1966), this Court held that a trustee appointed by a bankruptcy court to liquidate a corporation was indeed subject to penalties imposed by the Internal Revenue Code for his failure to fulfill his "duty to seek out and pay taxes accruing against the bankrupt estate during the bankruptcy itself."

Since 1978, section 3713 has contained an exception for "a case under title 11," which interlocks with that part of section 6012(b)(3) covering a "trustee in a case under title 11." If, as respondents[16] have argued, section 6012(b)(3)'s provision covering a "trustee in a case under title 11" does not apply to this trustee, section 3713(a) covers him and section 3713(b)'s exception from its personal liability provision similarly does not protect him. The exception for "a case under title 11" was added to section 3713 when the bankruptcy laws were revised in 1978; and the identical language was added to section 6012(b) when the tax laws were amended in 1980 to comport with the bankruptcy revisions. The identical language in these two statutes (enacted as part

[16] Although the United States is technically a respondent in No. 1361, *see* S. Ct. R. 12.4, we shall use the term "respondents" to refer solely to the Bank and the trustee.

of a comprehensive treatment of one subject) thus requires a uniform application.

The trustee cannot have it both ways—he either is, or is not, a trustee "in a case under title 11." Of course, if respondents are correct that he is not a trustee "in a case under title 11," then section 960, section 3713(a) and the other provisions of section 6012(b) still require him to pay the federal taxes—with the added incentive of absolute, statutory, personal liability for his failure to do so. As we develop below, the most logical construction of these interlacing and related statutes is that section 3713(a) applies wherever the system of priorities in section 507 of the Bankruptcy Code does not apply, and that this case should be governed, as to the Government's rights of priority by section 3713(a), and as to the trustee's personal liability by section 3713(b).

In short, the language of these three statutes—as confirmed by this Court and heretofore uniform court of appeals decisions—covers all insolvency fiduciaries, however appointed, rightfully or wrongfully, and, if in bankruptcy, at whatever stage in the proceedings appointed and by whatever authority. The statutory scheme works routinely when normal bankruptcy procedures are followed. Ordinarily, taxes incurred by a bankruptcy estate or corporation in bankruptcy during the administration phase of the case are given administrative expense priority under the Bankruptcy Code. 11 U.S.C. §§ 503(b)(1)(B); 507(a)(1). Here, however, the court of appeals held that the taxes could not be recovered as administrative expenses because they were "post-confirmation taxes." Pet. App. 9a; 911 F.2d at 1544. By using the "liquidating trust"—instead of liquidating the debtors in the proceeding itself, or requiring the debtors-in-possession to convey title to the Miami Center to the Bank—the Plan, according to the court of appeals, transmuted what otherwise would have been a priority claim solely against the estates into a claim against the "reorganized debtor[s]" after all of their property had been stripped from them and vested in the trustee.

But the matrix of statutes operates sweepingly in a nonroutine situation such as the scheme involved here. As the dissent below recognized, the court of appeals' decision erroneously "encroaches upon the IRS's ability to collect taxes successfully" (Pet. App. 16a; 911 F.2d at 1547) and vitiates the fresh start contemplated by the Bankruptcy Code—the debtors would emerge from bankruptcy, in respondents' view, with no assets, no visible means of generating income, and millions of dollars of federal income tax liability.

Recognizing the indefensibility of their extremist position—and of the court of appeals' opinion—respondents put forward (and presumably will renew) two side issues in opposition to certiorari. Respondents first contended that the debtors were grantors of a grantor trust. The court of appeals declined without comment to adopt that wholly unmeritorious argument. As the one court of appeals that has examined the question has concluded, the grantor trust rules were simply never intended to apply in bankruptcy. *DePinto* v. *United States*, 585 F.2d 405, 407 (9th Cir. 1978).

Respondents' second contention, that the case is somehow moot, is equally without merit. The bankruptcy "mootness doctrine" is a congressional regulation of the jurisdiction of Article III courts and of substantive bankruptcy law by way of a statutory requirement that the "validity" of certain sales by bankruptcy courts cannot be "affect[ed] by reversal on appeal. 11 U.S.C. § 363(m). *See In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1084-86 (3d Cir. 1990); *In re AOV Indus.*, 792 F.2d 1140, 1146-50 (D.C. Cir. 1986).

According to respondents, the debtors' failure to post a $50 million supersedeas bond in appealing the confirmation of the Bank's "cram-down" Plan immunizes the trustee from the obligations imposed on him by three federal statutes. That is absurd. A plan of reorganization simply cannot immunize a fiduciary operating under a plan from the operation of general federal statutory

law. Otherwise, the potential for abuse would be overwhelming—a host of federal statutes would be subject to a "bankruptcy exception" heretofore uncontemplated by Congress. A proponent may not propose a plan which does not comply with law and which enriches it to the detriment of the public fisc or by noncompliance with general statutory commands and then claim immunization by reason of the consummation of the plan. The court of appeals did not undertake to extend its "mootness doctrine" to the lengths respondents suggest. It addressed the merits of the case, as should this Court.

ARGUMENT

I. THE TRUSTEE IS RESPONSIBLE FOR THE PAYMENT OF FEDERAL INCOME TAXES AS A FIRST PRIORITY.

1. *The Interlacing Statutes.*—The plain language of three federal statutes requires the trustee to pay federal income taxes on the liquidation process. Section 960 of the Judicial Code applies to "any officers and agents conducting any business under authority of a United States court." Section 3713 of title 31 covers all representatives of insolvent persons, except in "a case under title 11." Section 6012(b)(3) of the Internal Revenue Code covers various fiduciaries with control over corporate assets by court order, by operation of law, or otherwise; and section 6012(b)(4) covers fiduciaries of trusts, estates and individuals in bankruptcy.

To some extent these statutes are overlapping and certain of them contain exceptions for cases covered by others of them. The priority of the United States may be affected by the decision as to which of the statutes are applicable in a particular case, and the personal liability of the fiduciary may be affected as well. We respectfully suggest that the Court rest its decision on the broadest of the applicable statutes, in order to prevent replication of the present scheme in other cases, to provide the high-

est level of priority for the United States,[17] and to promote compliance with our nation's voluntary system of taxation by giving trustees the added deterrent of personal liability for their failure to pay federal taxes. Such a choice would also further the collection of the taxes in this case, for the trustee has dissipated the trust assets and has not reserved sufficient funds for the payment of federal taxes. That would invoke taking respondents at their words that the trustee is not a "trustee in a case under title 11." The trustee should, of course, still be held to be bound by the provisions of section 960 of the Judicial Code, the absolute priority statute (31 U.S.C. § 3713), and the more general provisions covering "assignees" and other fiduciaries in I.R.C. § 6012(b)(3) and (4).

(a) *Section 960.*—Section 960 of the Judicial Code defines the standard of conduct for "any officers and agents conducting any business under authority of a United States court," requiring them to pay "all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation." 28 U.S.C. § 960. (Here, of course, I.R.C. §§ 1 and 11 impose the applicable taxes.) The court of appeals did not even acknowledge the statute's existence. This Court's decisions, however, and the legislative history confirm the clear congressional intent to subject a trustee like this one to federal income taxes.

The Court recently had occasion to speak to the applicability of section 960 to trustees appointed by bankruptcy courts in *California State Board of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844 (1989). The Court examined closely the language and history of section 960 and concluded that "[n]othing in the plain language of the statute, its legislative history, or the structure of the Bankruptcy Code indicates that Congress intended to exclude taxes on the liquidation process from those taxes

[17] Except in cases where the more complex series of priorities ordained by sections 503 and 507 of the Bankruptcy Code has clearly been provided.

the States may impose on the bankrupt estate." 490 U.S. at 853. The Court added, " '[b]y the sweeping terms of this statute all doubts have been resolved in favor of the state taxes.' " 490 U.S. at 858 n.9 (quoting *Thompson* v. *Louisiana*, 98 F.2d 108, 111 (8th Cir. 1938)). Since section 960 applies universally to "all Federal, State and local taxes," it requires a trustee appointed by a bankruptcy court in a plan under chapter 11 to pay federal income taxes "on the liquidation process." *Sierra Summit* thus interpreted the "plain meaning" of the language "conducting any business" as embracing the operations of liquidating a business or the estate of an entity conducting a business. 490 U.S. at 851.[18]

Other decisions of this Court confirm that the statute's plain language applies generally to taxation of all activities of all officers operating businesses under federal court authority, without exception. The Court first addressed the statute in 1939. Writing for a unanimous Court, Justice Black—who, as a Senator, was present when the Act was considered and passed in 1934[19]—recognized the broad applicability of the statute:

> Congress has here with vigor and clarity declared that a trustee and other court appointees who operate businesses must do so subject to State taxes "the same as if such business[es] were conducted by an individual or corporation." . . . The Act of 1934 indicates a Congressional purpose to facilitate—not to obstruct—enforcement of State laws . . . .

Boteler v. *Ingels*, 308 U.S. 57, 61 (1939).[20]

[18] The Court in *Sierra Summit* also reviewed lower court authority and indeed reversed one of the cases upon which respondents relied in the court of appeals in this case and overruled several others. 490 U.S. at 846 n.2.

[19] 78 Cong. Rec. 11,466 (1934).

[20] In a footnote, the Court reserved the question "[w]hether the trustee might be personally surcharged because [of] his refusal to pay the fees." 308 U.S. at 60 n.6. Until now, the Court still has not had occasion to speak to the prospect of such liability arising out of a violation of section 960. However, it appears that such liability

In *Palmer* v. *Webster & Atlas National Bank*, 312 U.S. 156, 163 (1941), the Court reaffirmed that "Congress intended . . . that a business in receivership, or conducted under court order, should be subject to the same tax liability as the owner would have been if in possession and operating the enterprise." [21]

The legislative history confirms Congress' sweeping intent in passing and revising this statute. The committee reports reflected Congress' displeasure with a federal court ruling that held federal court receivers exempt from state taxes. The reports concluded that "[n]o good reason is perceived why a receiver should be permitted to operate under such an advantage as against his competitors not in receivership, and the States and local governments be deprived of this revenue." [22] The 1934 Act therefore subjected a "receiver, liquidator, referee, trustee, or other officer or agent appointed by any United States court" to "all State and local taxes." Act of June 18, 1934 (formerly codified at 28 U.S.C. § 124a (1940)).

When Congress revised the Judicial Code in 1948, it made two changes to the language of the statute. First,

would further the purposes of section 960 by encouraging voluntary compliance with the federal tax laws, consistent with the common law duties of trustees. *See* p. 33 n.38, *infra*. The point need not be reached if section 3713 is found to apply, because of the absolute personal liability provisions contained therein.

[21] In *Palmer*, the Court held that the trustees, who were administering two bankrupt estates (312 U.S. at 160), could not use the assets of one estate to pay the taxes of another. 312 U.S. at 163. Here, the trustee is responsible for five separate estates, and should not be permitted to use the assets of one to pay the taxes of any other, except to the extent that the modified form of substantive consolidation approved by the bankruptcy court (*see* p. 4 n.5, *supra*) permits the use of Holywell's funds after all of Holywell's creditors, including the United States and Virginia, have been paid.

[22] H.R. Rep. No. 1138, 73d Cong., 2d Sess. 1 (1934); S. Rep. No. 1372, 73d Cong., 2d Sess. 1 (1934). The bill was amended on the House floor without debate to apply not only to receivers but to a "liquidator, referee, trustee, or other officer or agent." 78 Cong. Rec. 6,656 (1934).

Congress deleted the specific enumeration of "receiver" "liquidator," "referee" and "trustee" as redundant. H.R. Rep. No. 308, 80th Cong., 1st Sess. 5, A103. This only confirms that the words "any officers and agents" mean what they say, and that any limitation would be contrary to congressional intent.

Second, Congress added "Federal" taxes to the coverage of the statute, "in recognition of the liability of such officers [*i.e.*, "any officers"] for Federal taxes under the revenue laws." *Id.* Thus, in 1948, Congress recognized the repeated expressions of congressional intent that subject "*any* officers and agents conducting any business under authority of a United States court" to federal taxes, and ensured that section 960 would define the standard of conduct for court-appointed officers with respect to federal, as well as state and local, taxes.

(b) *The Absolute Priority Statute.*—The overriding intent of Congress that *all* fiduciaries of insolvent entities bear responsibility for federal taxes is further demonstrated by 31 U.S.C. § 3713, which is older than the Bill of Rights and almost as old as the Constitution itself.[23] That statute mandates that, where "a person indebted to the Government is insolvent" and "an act of bankruptcy is committed," [24] a claim of the United States "shall be

[23] Its predecessor was the fifth statute passed by the First Congress, Act of July 31, 1789, ch. 5, § 21, 1 Stat. 29, 42, "and its roots reach back even further into the English common law; the Crown exercised a sovereign prerogative to require that debts owed it be paid before the debts owed other creditors. Many of the States claim the same prerogative, as an inherent incident of sovereignty." *United States* v. *Moore*, 423 U.S. 77, 80 (1975) (citations omitted).

[24] The concept of "acts of bankruptcy" (not found in the Bankruptcy Code of 1978) derives from the old Bankruptcy Act of 1898 and its predecessors and the laws of the states during periods when there was no federal bankruptcy act. *Bramwell* v. *United States Fidelity & Guaranty Co.*, 269 U.S. 483, 489 (1926); *United States* v. *Oklahoma*, 261 U.S. 253, 262 (1923); *Conard* v. *Nicoll*, 29 U.S. (4 Pet.) 291, 308 (1830) (charge of Washington, Circuit Justice, reprinted by order of the Court). The debtors' filing of voluntary cases in bankruptcy satisfies this requirement of section 3713(a), because

paid first." 31 U.S.C. § 3713(a)(1)(A)(iii). To ensure compliance, the statute historically in substance has provided—as its current text expressly provides—that "[a] representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government." 31 U.S.C. § 3713(b).

"Since the earliest days of the republic, [section 3713] and its predecessors have given the Government priority over all other claimants in collecting debts due it from insolvent debtors." *United States* v. *Key*, 397 U.S. 322, 324 (1970). The Court has consistently given this statute a liberal construction in order to ensure the flow of the public revenues:

> As Mr. Justice Story wrote for the Court in 1832, the priority proceeds from "motives of public policy, in order to secure an adequate revenue to sustain the public burthens and discharge the public debts. . . . [A]s that policy has mainly a reference to the public good, there is no reason for giving to [the statute] a strict and narrow interpretation." For nearly two centuries this Court has applied the statute with this policy in mind.

United States v. *Moore*, 423 U.S. at 81-82 (quoting *United States* v. *State Bank*, 31 U.S. (6 Pet.) 29, 35 (1832)); *accord, e.g., United States* v. *Emory*, 314 U.S. at 426; *Bramwell* v. *United States Fidelity & Guaranty Co.*, 269 U.S. at 487; *United States* v. *Fisher*, 6 U.S. (2 Cranch) 358, 386 (1805) (Marshall, C.J.).

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it was the sixth "act of bankruptcy" under section 3.a(6) of the old Act (former 11 U.S.C. § 21.a(6) (1976)); *see also United States* v. *Texas*, 314 U.S. 480, 483 (1941) (act of bankruptcy under this statute clearly includes appointment of receiver to liquidate business); *United States* v. *Emory*, 314 U.S. 423, 426 (1941) (same). Unless the old Act's definitions are used (or the Court's earlier decisions interpreting "act of bankruptcy"), section 3713(a)(1)(A)(iii) would be a nullity.

The manner in which the statute operates has been well described in a case decided over a century and a half ago, when the statute (apart from the exception for the Bankruptcy Code) had the same structure as it now has:

> From the language employed in this section, and the construction given to it, from time to time, by this Court, these rules are clearly established: first, that no lien is created by the statute: secondly, the priority established can never attach while the debtor continues the owner and in the possession of the property, although he may be unable to pay all his debts: thirdly, no evidence can be received of the insolvency of the debtor, until he has been divested of his property in one of the modes stated in the section: and fourthly, whenever he is thus divested of his property, the person who becomes invested with the title, is thereby made a trustee for the United States, and is bound to pay their debt first out of the proceeds of the debtor's property.

Beaston v. *Farmers' Bank*, 37 U.S. (12 Pet.) 102, 133-34 (1838).[25]

The Court held this statute to persist in the presence of other, later enacted specific statutes, including the Bankruptcy Act of the day. *See, e.g., United States* v. *Key*, 397 U.S. at 325-27 (Chapter X, added by the Chandler Act of 1938 to the Bankruptcy Act of 1898). Indeed, in *King* v. *United States*, 379 U.S. 329, 338-39 (1964), following the principle that the statute should be applied to all assignees of insolvents, this Court held the statute applicable to a disbursing agent under the Bankruptcy Act of 1898. Like respondents here, King argued that he performed "only the ministerial function of paying out the deposited funds in conformity with the court's orders." 379 U.S. at 338. The Court rejected that argument as counter to the actual power King possessed. The powers of the trustees here (*see* pp. 5-6, *supra*), not only

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[25] *Beaston* has been quoted and paraphrased by this Court in the present century. *Bramwell* v. *United States Fidelity & Guaranty Co.*, 269 U.S. at 488; *King* v. *United States*, 379 U.S. at 336-38.

equalled but far outstripped those of the disbursing agent in *King* and thus the present case is an *a fortiori* one from that case. In addition, King—like respondents here—argued that he was not responsible to pay the Government's claim because the bankruptcy court's order confirming the plan of arrangement did not provide for payment of the claim. 379 U.S. at 338-39. The Court rejected that argument, as well, in light of the "degree of control" that King possessed. 379 U.S. at 339.

(c) *I.R.C. Section 6012(b)*.—Congress' "recognition" in 1948, that "any officers and agents conducting any business under authority of a United States court" were liable "for Federal taxes under the revenue laws" (*see* p. 21, *supra*), was supported by the plain language of a statute that had not been materially altered since the passage of the Sixteenth Amendment; by the Treasury Department's long-standing and unequivocal interpretation of the statute; and by uniform federal court application of the statute.

In 1948, section 6012(b)(3)'s predecessor applied to "receivers, trustees in bankruptcy, or assignees" who were "operating the property or business of corporations." Internal Revenue Code of 1939, § 52. Today, the statute remains substantially unchanged.[26] It is part of section

[26] Two revisions have since been made to the language. The first took place in 1954. Prior to that time, a minority of courts had held that "mere" liquidation activities did not constitute "operating" the business under the statute. *E.g.*, *In re Heller, Hirsch & Co.*, 258 F. 208 (2d Cir. 1919); *In re Owl Drug Co.*, 21 F. Supp. 907 (D. Nev. 1937). As noted above, this Court later reached the conclusion that liquidation activities constitute "conducting" a business under section 960. *See* p. 19, *supra*. In the 1954 Code, Congress made a "clarifying change from the wording of existing law" (H.R. Rep. No. 1337, 83d Cong., 2d Sess. A396, *reprinted in* 1954 U.S. Code Cong. & Admin. News 4017, 4543; S. Rep. No. 1622, 83d Cong., 2d Sess. 563, *reprinted in* 1954 U.S. Code Cong. & Admin. News 4621, 5211) by eliminating the language "operating the business or property of corporations" from the statute and instead providing that section 6012(b)(3) would apply "whether or not such property is being operated." This change was thus intended to confirm the broad reach and intention of the statute.

Second, as part of the Bankruptcy Tax Act of 1980, the words "trustees in bankruptcy" were replaced with "trustee in a case under title 11 of the United States Code." This was a "conforming amendment" made "to substitute references to bankruptcy cases under new title 11 of the U.S. Code for references to bankruptcy proceedings under the now-repealed Bankruptcy Act." S. Rep. No. 1035, 96th Cong., 2d Sess. 52, *reprinted in* 1980 U.S. Code Cong. & Admin. News 7017, 7065.

6012, which identifies the persons required to make returns. Subsection (a) prescribes the general and familiar rule requiring individuals, corporations, estates, trusts, and other entities to make returns. Subsection (b) then prescribes rules for the filing of returns by "fiduciaries and receivers"—in cases of decedents (§(b)(1)); persons under a disability (§(b)(2)); corporations whose assets are held by receivers, trustees or assignees (§(b)(3)); and estates, trusts and estates of individuals under chapter 7 or 11 of title 11 (§(b)(4)).

Within this structure, Congress provided in subsection (b)(3) for the filing of returns for a corporation where substantially all of its assets are held by a fiduciary. Section 6012(b)(3) therefore applies broadly in any case "where a receiver, trustee in a case under title 11 of the United States Code, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation." I.R.C. § 6012(b)(3). A fiduciary within the ambit of the statute's language must file the corporation's federal income tax returns "in the same manner and form as corporations are required to make such returns," and, by operation of I.R.C. § 6151(a), pay the taxes. Although subsection (b)(3) is limited to corporations, subsection (b)(4) provides that "[r]eturns of an estate, a trust, or an estate of an individual under chapter 7 or 11 of title 11 shall be made by the fiduciary thereof." [27]

[27] Section 6012(b)(4)'s predecessors required the fiduciary of an "estate" or a "trust" to make returns. *See, e.g.*, section 142(a) of

The sweeping language of these two provisions thus gives explicit instructions to fiduciaries of all descriptions that they must report the income of their charges and pay the concomitant federal taxes. I.R.C. § 6151(a).

This interpretation of the statute is supported by long-settled court of appeals authority. Since the passage of the statute shortly after the enactment of the Sixteenth Amendment, the courts of appeals, with the singular exception of the Eleventh Circuit in this case, have required fiduciaries—however they come into control of corporations' or individuals' assets and whatever their formal titles—to file federal income taxes.[28] As Judge

the Internal Revenue Code of 1939; section 6012(b)(4) of the Internal Revenue Code of 1954. In 1980, Congress added language imposing the same requirement on the fiduciary of "an estate of an individual under chapter 7 or 11 of title 11." Pub. L. 96-589, § 3(b)(2), 94 Stat. 3389, 3401.

[28] *See In re Joplin*, 882 F.2d 1507, 1508 (10th Cir. 1989) (trustee appointed in individuals' chapter 7 liquidation proceeding); *In re Sapphire S.S. Lines*, 762 F.2d 13, 14 (2d Cir. 1985) (trustee appointed in bankruptcy case); *In re I.J. Knight Realty Corp.*, 501 F.2d 62, 64 (3d Cir. 1974) (trustee appointed in bankruptcy case); *United States* v. *Sampsell*, 266 F.2d 631, 632-34 (9th Cir. 1959) (same); *Hersloff* v. *United States*, 310 F.2d 947, 950 & n.5 (Ct. Cl. 1962) (liquidating trustees), *cert. denied*, 373 U.S. 923 (1963) [decisions of the Court of Claims issued prior to the creation of the Federal Circuit are binding in that Circuit, *South Corp.* v. *United States*, 690 F.2d 1368, 1369 (Fed. Cir. 1982) (in banc)]; *United States* v. *Loo*, 248 F.2d 765, 768 (9th Cir. 1957) (trustee appointed by state court), *cert. denied*, 356 U.S. 928 (1958); *Pinkerton* v. *United States*, 170 F.2d 846, 847-48 (7th Cir. 1948) ("liquidating receiver" appointed by state court); *Louisville Property Co.* v. *Commissioner*, 140 F.2d 547, 549-50 (6th Cir.) (court-ordered receiver for purposes of liquidation), *cert. denied*, 322 U.S. 755 (1944); *Kavanagh* v. *First Nat'l Bank*, 139 F.2d 309, 312 (6th Cir. 1943) (receiver of insolvent national bank); *First Nat'l Bank* v. *United States*, 86 F.2d 938, 941 (10th Cir. 1936) (trustee for corporation); *Northwest Utils. Sec. Corp.* v. *Helvering*, 67 F.2d 619, 620 (8th Cir. 1933) ("trustees in dissolution"), *cert. denied*, 291 U.S. 684 (1934); *Scott* v. *Western Pac. R.R.*, 246 F. 545 (9th Cir. 1917) (receiver appointed by federal court) (dictum); *see also Tazewell Elec. Light & Power Co.* v. *Strother*, 84 F.2d 327, 329 (4th Cir. 1936) ("liquidating trustee" covered by regulations promulgated under statute); *Whitney Realty Co.* v. *Commissioner*, 80 F.2d 429, 431 (6th Cir. 1935) (same for "liquidating agent"), *cert. denied*, 298 U.S. 668 (1936); *Hellebush* v. *Commissioner*, 65 F.2d 902, 903 (6th Cir. 1933) (same for trustees appointed to effect "final liquidation"); *Taylor Oil & Gas Co.* v. *Commissioner*, 47 F.2d 108, 109 (5th Cir.) (same for "liquidating trustees"), *cert. denied*, 283 U.S. 862 (1931).

Jerome Frank once observed in discussing the applicability of this statute to one corporation in the process of liquidation, "[p]etitioner suggests no reason why its position should be held so anomalous that it does not fit into a framework in which business units of every description, of long or short duration, must share in the cost of society. This is the price of existence." *O'Sullivan Rubber Co.* v. *Commissioner*, 120 F.2d 845, 847 (2d Cir. 1941). Like the petitioner in *O'Sullivan Rubber*, the Eleventh Circuit offered no reason why a "liquidating trustee" should be treated differently from any other fiduciary. Thus, there can be no question that section 6012 (b) covers the trustee here both as to the corporate and the individual debtors.

(i) *The Corporations*—First, as Judge Cox pointed out in his dissent, the trustee here is an "assignee, by order of a court of competent jurisdiction, by operation of law or otherwise," of the debtors' property and, as such, is required to file the corporate debtors' returns under section 6012(b)(3). This portion of the statute's language is sweeping and compelling, with no limiting language restricting the term to only certain kinds of assignees, and myriad courts of appeals have held the statute applicable to a wide variety of court-appointed and contractually designated assignees, regardless of the method of their acquisition of the corporation's assets. *See* pp. 26-27 n.28, *supra*. Simply put, the statutory coverage of "an assignee, by order of a court of competent jurisdiction, by operation of law or otherwise" is not susceptible to an exception for a "contract trustee."

The majority in the court of appeals struggled with the question whether the trustee here was a "trustee in

a case under title 11," and respondents continued to contend he is not in opposing certiorari. Given the structure of section 6012(b)(3) with its broad and inclusive references to assignees and receivers—fiduciaries who acquire possession of the assets or estates of financially troubled corporations either by court order or by private arrangement—the question appears to be beside the point, and need not be reached. Of course, the bankruptcy court's jurisdiction, as here pertinent, extends only to "cases under title 11." 28 U.S.C. §§ 157(b), 1334. And this trustee was called a "trustee"—and section 1123 (a)(7) of the Bankruptcy Code contemplates the possibility of the selection of a "trustee" under a plan of reorganization, although it is far from clear that this section *properly* authorized the appointment here. Thus, it could hardly be said that the trustee *in no way* was a "trustee in a case under title 11."

But let us assume respondents' point for the sake of argument; it does not change the result. This clearly was no conventional trustee in bankruptcy; he did not function during the administrative phase of the case. To be sure, while the powers, functions and duties of the trustee in this Plan crafted by the Bank (including the emulation of the fidelity bond required by section 322(a) of the Bankruptcy Code) were chosen to emulate the powers, functions and duties of a trustee appointed for the administration of an ongoing bankruptcy case, it is the case that when the trustee was appointed and took over the property of the debtors, the Plan had been confirmed; that is the usual point where a trustee is discharged rather than when he takes office. But, even if this particular provision of section 6012(b)(3) does not reach this trustee, other provisions of that subsection—those referring to assignees and receivers, in an inclusive form—do so (as to the corporate debtors); as noted above, section 960 of the Judicial Code also reaches this trustee; and so does section 3713 of title 31.

That the trustee here is covered by the plain language of section 6012(b)(3) as to the corporate debtors is con-

firmed by the history of the statute, and thus, without reference to whether he was technically a "trustee in a case under title 11." Beginning with section 13(c) of the Revenue Act of 1916,[29] Congress required "receivers, trustees in bankruptcy, or assignees" to file the federal income tax returns of the corporations they were responsible for. This section has been reenacted in every subsequent recodification of the internal revenue laws and is part of the present Internal Revenue Code.[30] The regulations of the Treasury Department promulgated in 1919, under the first reenactment of the provision, construed the statutory language to cover "trustees in dissolution."[31] Article 547 of Treasury Regulation 45 (1920 ed.) explained:

> When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss.[32]

This contemporaneous administrative construction, which has never been modified in the numerous reenactments of

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[29] Pub. L. 64-271, 39 Stat. 756, 771.

[30] The relevant statutory provisions ranged from section 239 of the Revenue Act of 1918, Pub. L. 65-254, 40 Stat. 1057, 1081, to section 52 of the Internal Revenue Code of 1939, Pub. L. 76-1, 53 Stat. 1, 27-28.

[31] Treas. Reg. 45, art. 622 (1919); *accord* Treas. Reg. 62, art. 622 (1922 ed.); Treas. Reg. 65, art. 622 (1924); Treas. Reg. 69, art. 622 (1926); Treas. Reg. 74, art. 392 (1931); Treas. Reg. 77, art. 392 (1933); Treas. Reg. 86, art. 52-2 (1935); Treas. Reg. 94, art. 52-2 (1936); Treas. Reg. 111, § 29.52-2 (1943); Treas. Reg. 118, § 39.52-2 (1953); Treas. Reg. § 1.6012-3(b)(4) (1960). The present regulation, Treas. Reg. § 1.6012-(3)(b)(4) (1990), also interprets section 6012(b) as applying to "trustees in dissolution."

[32] *Accord* Treas. Reg. 62, art. 548; Treas. Reg. 65, art. 548; Treas. Reg. 69, art. 548; Treas. Reg. 74, art. 71; Treas. Reg. 77, art. 71; Treas. Reg. 86, art. 22(a)-21; Treas. Reg. 94, art. 22(a)-21; Treas. Reg. 111, § 29.22(a)-20; Treas. Reg. 118, § 39.22(a)-20.

the statute, provides express evidence of specific intent that section 6012(b) requires any officer appointed "for the purpose of liquidating the assets and paying the debts" of a corporation to file federal income tax returns and pay federal taxes regardless of the mechanism of the trustee's appointment.[33]

(ii) *The Individual Debtor*—While section 6012(b)(3) requires the trustee to file the corporations' returns, subsection (b)(4) operates in much the same way with respect to the individual returns involved here. The trustee was appointed as the fiduciary of a trust and took possession of all of the assets of the estate of Theodore B. Gould, as it existed at the commencement of the case. He has received millions of dollars of income in respect of the fiduciary estate. Therefore, the trustee is a "fiduciary" of a "trust" within the meaning of section 6012(b)(4) and must file returns reflecting the income attributable to assets comprising the estate of Gould, as well as the returns of the corporations. The Internal Revenue Code defines a "fiduciary" to include "a guardian, trustee, executor, administrator, receiver, conservator, or *any person acting in any fiduciary capacity for any person.*" I.R.C. § 7701(a)(6) (emphasis added). Neither the majority of the court of appeals nor the respondents have offered any reason why this "trustee," as a "fiduciary" of a "trust" is not (as Judge Cox recognized in his dissent, Pet. App. 15a; 911 F.2d at 1547) covered by the explicit language of section 6012(b)(4).[34]

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[33] Where Congress has, in many reenactments of a tax statute, declined to override a contemporaneous and long-continued administrative construction, the construction "must be deemed to have received congressional approval" and to have the effect of law. *Fribourg Navigation Co.* v. *Commissioner,* 383 U.S. 272, 283 (1966); *see Wilmette Park Dist.* v. *Campbell,* 338 U.S. 411, 417-18 (1949); *Helvering* v. *Winmill,* 305 U.S. 79, 83 (1938).

[34] In addition, the trustee should be covered by the requirement that the fiduciary of "an estate of an individual under Chapter 7 or 11" file returns. It is true that the "estate of an individual under Chapter 11" terminated in this case upon confirmation of the Plan of Reorganization. But the clear purpose of the statute is to bring within its scope all situations where persons control substantially all of the assets of another. The trustee should not be permitted to escape that broad purpose because he was appointed after administration of the estate terminated.

(d) *The Interaction Between the Absolute Priority Statute and Title 11 of the Bankruptcy Code.*—There is an exception in section 3713(a), the substantive portion of the absolute priority statute, for "a case under title 11," and in subsection (b) of section 3713, the personal liability provision, for "a trustee acting under title 11." These related exceptions came into the statute in 1978. The references in the exceptions to a case under title 11 and to a trustee acting thereunder are references to a bankruptcy or reorganization trustee in the usual sense of a trustee functioning in the administration phase of a case, and not to the present trustee.

When Congress revised the bankruptcy laws in 1978, it altered the treatment of unsecured federal tax claims arising before the filing of the bankruptcy petition ("prepetition" claims), giving most of them seventh priority (11 U.S.C. § 507(a)(7)); taxes arising after the filing of the bankruptcy petition and during the pendency of the bankruptcy case ("postpetition," or "administrative" taxes) were specifically given first priority (11 U.S.C. §§ 507(a)(1), 503(b)(1)(B)), albeit *pari passu* with other administrative claims. *See* 3 *Collier on Bankruptcy* ¶ 503.03, at 503-15 (L. King 15th ed. 1991). The exception to section 3713(a) for "a case under title 11" was also added then,[35] presumably to ensure the application of these congressional choices—including the determination that "administrative expenses include taxes which the trustee incurs in administering the debtor's estate, including taxes on capital gains from sales of property by the trustee and taxes on income earned by the estate during the case." S. Rep. No. 989, 95th Cong.,

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[35] Bankruptcy Reform Act of 1978, Pub. L. 95-598, § 322, 92 Stat. 2549, 2678-79 (1978).

2d Sess. 66, *reprinted in* 1978 U.S. Code, Cong. & Admin. News 5787, 5852.

Two years later, Congress added the exact same language ("trustee in a case under title 11") to section 6012(b)(3) as a "conforming amendment."[36] Section 6012(b)(3)—along with the priority set out in the Bankruptcy Code—therefore closes the circle by providing that a "trustee in a case under title 11" is required to file returns and pay taxes incurred during the administration of the estate. A first-level priority was preserved for such taxes by Bankruptcy Code sections 503 and 507.

All agree that if this trustee had sold the Miami Center during the administration of the case, he would have been liable under section 6012(b)(3), as a "trustee in a case under title 11," to file the returns and pay the taxes. All also agree that if that had occurred, the taxes would have been entitled to first priority, albeit with other administration claims. Here, however, the bankruptcy court appointed the trustee to serve only after the administration of the case ended, and the trustee did not engage in taxable activity until after the administration phase was over.[37] Therefore, respondents contend, the trustee is not covered by the words "trustee in a case under title 11"; for the sake of argument, let us accept that contention. But they further contend the taxes are not entitled to any priority at all; that is unsupportable. The two statutes (which were modified to contain the same language as part of Congress' comprehensive revision of the Bankruptcy laws) must be read together. Either the trustee is a trustee "in a case under title 11," or he is not. If so, he is concededly covered by the narrow term in I.R.C. § 6012(b)(3) (as well as by the broader terms in that subsection and in subsection 6012

[36] Bankruptcy Tax Act of 1980, Pub. L. 96-589, § 6(i)(5), 94 Stat. 3389, 3410.

[37] Confirmation of a reorganization plan terminates the administration phase of the case and, in most circumstances, discharges the debtor. 11 U.S.C. § 1141.

(b)(4), and in section 960) and is required to file the returns and pay the taxes as a first priority administrative expense.

If, on the other hand, respondents are correct that the trustee is not a "trustee in a case under title 11," the trustee falls outside the exception contained in 31 U.S.C. § 3713(a), and (1) the Government's absolute priority supersedes the claim of any other creditor under the plain language of the statute and two centuries of undisturbed precedent enforcing it; and (2) the trustee is subject to absolute, statutory, personal liability for making distributions that contravene that priority.[38] To hold that the circle is broken—and that a trustee appointed by a United States court to succeed to an insolvent estate and serve pursuant to a bankruptcy reorganization plan can elude the tax collector entirely, let alone the collector's priorities—is an aberrant and illogical result.

The present case, we submit, should best be held not to be within the exception for "a case under title 11" in the substantive subsection of the absolute priority statute, section 3713(a). Section 3713 is the more general statute, having been on the books for two centuries, having had a history of broad construction, and having been held, absent express exception, to persist despite the presence of a federal bankruptcy act. The exception from the substantive priority provision of section 3713(a) is obviously designed to comport with the priority section of the Bank-

[38] Of course, this is not to say that the trustee is *exonerated* from personal liability if he is held to be a "trustee in a case under title 11." He still faces liability under section 960 and under general trust principles for his breach of fiduciary duties. *See Boteler* v. *Ingels*, 308 U.S. at 60 n.6 (leaving open the question whether section 960 requires personal liability for failure to pay taxes); *Restatement (Second) of Trusts* §§ 201 & comment b; 202 & comments j & n & illus. 28; 205 (1959) (setting forth general principles of trustee's personal liability for wrongful disbursal and commingling of trust funds); *cf. United States* v. *Crocker*, 313 F.2d 946, 949 & n.14 (9th Cir. 1963) ("A fiduciary is not relieved of liability [under section 3713] because distribution in disregard of the government's priority has been approved by the court.").

ruptcy Code, 11 U.S.C. § 507. But claims subject to the priorities defined in section 507 of the Bankruptcy Code are restricted to those either (a) arising during the administration of the case (and hence, generally entitled to first priority) or (b) in existence at the time of the commencement of the case. *See* Pet. App. 9a; 911 F.2d at 1544; *United States* v. *Redmond*, 36 Bankr. 932, 934 (D. Kan. 1984). Section 507 does not address the priority of claims arising out of events subsequent to the confirmation of a plan of reorganization and subsequent to the administration of the case. *Id.* The tax claims here are post-confirmation taxes not dealt with in section 507. Obviously, their priorities were left for determination by the provisions of section 3713(a).

It would follow from this that for purposes of the personal liability subsection of this statute, section 3713(b), this trustee should not be held to be "a trustee acting under title 11," language which is clearly used in subsection (b) in the same sense as the similar language in subsection (a). This reading of the phrase "trustee in a case under title 11" would promote the federal policy of ensuring the collection of federal taxes—by assuring that a fiduciary appointed as part of a reorganization plan and acting in the post-confirmation time frame who fails to pay federal taxes faces absolute, statutory, personal liability for his infidelity to the United States. As noted, such a reading of the phrase "trustee in a case under title 11" would not blunt the applicability of the remainder of section 6012(b)—nor of section 960.

In sum, Congress has enacted a comprehensive system of interlacing statutes requiring trustees, assignees, receivers, and other fiduciaries for insolvents to file returns for and pay the taxes of their charges. The statutes may well be "redundant." *See* 1 *Collier on Bankruptcy* ¶ 8.02, at 8-15. That is because Congress acted both early and late, repeatedly, and out of an excess of caution.

2. *The Consequences of a Judge-Made Exception for Liquidating Trustees.*—The court of appeals' decision

contravenes and undermines this system and gives bankruptcy creditors the opportunity to set up a creature, the "liquidating trustee," with a license to engage in taxable activities without the filing of returns and payment of taxes—a new form of extra-legislative tax-exemption. By immunizing the liquidating trust and its proceeds from obligations to pay federal income tax—whether on capital gains or on ordinary income, such as interest income on Treasury securities and other money market investments in the trust—this creditor-drafted plan permitted the creditors of the insolvent debtors to obtain numerous windfalls without competition from the Government's claim for federal income taxes. Although the Bank's mortgage claim on the Miami Center property was found to be "undersecured" and thus ordinarily not entitled to interest accruing after the commencement of the case ("postpetition interest"), *see* p. 3 & n.4, *supra*, the Plan of Reorganization provided that such postpetition interest (in excess of $27 million) was to be paid in full and indeed that interest was to be paid at a rate higher than that provided for in the governing instruments. *See In re Holywell Corp. (Holywell Corp.* v. *Bank of New York)*, 901 F.2d 931, 933 (11th Cir. 1990), *cert. denied*, 111 S. Ct. 713 (1991). An estate swollen by the retention of moneys otherwise due the Federal Government for taxes yields itself readily to such payments to the creditors in lieu of those due to the public Treasury.

The holding below raises the possibility—indeed the probability—that "liquidating trustees" will become the norm in cases where a matter begun as a corporate or business reorganization under the Bankruptcy Code turns into one in which a substantial or total liquidation of the business' property takes place.[39] Instead of converting

[39] No official statistics are kept or compiled concerning the use of liquidation plans in chapter 11 cases. However, in October 1989 the Administrative Office of the United States Courts reported that it had retained the accounting firm of Ernst & Young to conduct a study of chapter 11 cases. Although Ernst & Young did not specifically study the frequency or extent of the use of liquidating

such cases to a chapter 7 liquidation or leaving the debtor as a debtor-in-possession to liquidate the business under court supervision, a standard form "Plan of Reorganization," similar to the one here, can be adopted conveying all the debtor's assets to a "liquidating trustee," who is charged with liquidating the debtor's property but is exempt from the various federal statutes requiring the payment of federal income taxes. Indeed, the use of a "liquidating trust" in chapter 11 cases is already of increasing popularity.[40] It will only become more so once it is viewed by creditors as a means of avoiding tax obligations.

The suggestion of the majority of the court of appeals that the "reorganized debtor," not the trustee, is liable for the federal income taxes incident to the trustee's operations not only rewrites the statutes but elects the source least likely to have funds to pay the federal income taxes to be the party responsible for paying them. It facilitates the use of the liquidating trust as a tax-avoidance device. It may be anticipated that in the usual case of a liquidating plan the debtor will be stripped of all or substantially all of its property, and the same placed in the "liquidating trust," as was the case here.

plans, it estimated that approximately 20 to 30 percent of the chapter 11 cases reviewed were liquidations. E. Flynn, Bankr. Div., Admin. Off. of U.S. Courts, *Statistical Analysis of Chapter 11* at 12 (October 1989). In fiscal 1989, more than 17,000 chapter 11 cases were filed. Annual Report of the Director of the Administrative Office of United States Courts 362 (1989). This would suggest that 3,500 to 5,000 cases begun in chapter 11 each year turn into liquidations.

[40] For several recent cases utilizing a "liquidating trust" in a chapter 11 reorganization, see, *e.g.*, *Toren* v. *Braniff, Inc.*, 893 F.2d 763, 765 (5th Cir. 1990); *In re Highway Equip. Co. (Highway Equip. Co.* v. *Alexander Howden Ltd.)*, 120 Bankr. 910, 911 (Bankr. S.D. Ohio 1990); *In re Crowthers McCall Pattern, Inc.*, 120 Bankr. 279, 283 (Bankr. S.D.N.Y. 1990); *In re Mako, Inc.*, 120 Bankr. 198, 200 (Bankr. E.D. Okla. 1990); *In re Mortgage Inv. Co.*, 111 Bankr. 604, 609 (Bankr. W.D. Tex. 1990). (We do not mean to suggest that in those cases the fiduciaries did not file tax returns; the point is that under the court of appeals' holding such fiduciaries may take the position that they need not do so.).

Where corporations are involved, this leaves essentially a corporate shell holding the obligation to pay the taxes; and thus, the Treasury is left holding the bag. Where, however, as with one of the debtors here, a debtor is an individual, such a debtor could not possibly enjoy "a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Local Loan Co.* v. *Hunt*, 292 U.S. 234, 244 (1934). The court of appeals' decision to this extent would undermine the "fresh start" that is "a central purpose of the [Bankruptcy] Code." *Grogan* v. *Garner*, 111 S. Ct. 654, 659 (1991). One pair of commentators (after studying this question) observed that "[n]o useful purpose is served by shifting to the bankrupt the tax upon the unrealized appreciation in his assets, which appreciation is realized upon liquidation in bankruptcy. Such tax treatment simply would frustrate the theory of rehabilitation of giving a debtor a fresh start . . . ." Krause & Kapiloff, *The Bankrupt Estate, Taxable Income and the Trustee in Bankruptcy*, 34 Fordham L. Rev. 401, 417 (1966); *cf. In re Bentley*, 916 F.2d 431, 432-33 (8th Cir. 1990).[41]

This Court should not countenance the continued possibility of any such scheme. The Court should determine that the absolute priority statute, section 3713 of title 31, applies to this case, as well as to every other case of the devolution of an insolvent person's estate upon a fiduciary

[41] Congress has determined that it is the *estate*, not the emerging debtor, which is responsible (with a lone, clearly demarcated, and irrelevant exception) for the payment of taxes incurred in the administration of the bankruptcy proceedings. *See* 11 U.S.C. § 346(b)(1) (income of individual may be taxed by state and local authorities only to the estate); 11 U.S.C. § 346(f) (trustee must pay state and local withholding taxes); 11 U.S.C. §§ 1129(a)(7), 726(a)(1), 507(a)(1), 503(b)(1)(B)(i) (together, prohibiting a plan of reorganization from being approved if it would provide for payment of any unsecured claims before any tax "incurred by the estate" (§ 503(b)(1)(B)(i)). The exception is 11 U.S.C. § 346(d) (state and local income tax on individual in Chapter 13 may be imposed only on debtor, not estate).

as a result of the bankruptcy process or the other processes specified in the section; should hold that section 960 of the Judicial Code is applicable; and should hold that the sweeping language referring to all sorts of "assignees" and "fiduciaries" in sections 6012(b)(3) and (4) of the Internal Revenue Code also governs.

II. THE COURT OF APPEALS' "MOOTNESS DOCTRINE" DOES NOT PRECLUDE REVIEW OF THE TRUSTEE'S LIABILITY, OR HIS PURSUIT OF CLAIMS AGAINST THE BANK.

In addition to its unprecedented and unsupported interpretation of section 6012(b), the court of appeals also held that the so-called "mootness doctrine" in bankruptcy cases prohibited it from considering two of the trustee's three allegations in his complaint concerning the Bank's vicarious liability for the payment of the taxes: (1) the Bank is liable for the taxes because it committed a fraud on the court by failing to disclose its intentions concerning taxes, and (2) it is liable because it proposed a plan without providing the means to pay the taxes.[42] But the court rejected respondents' argument that the issue of the *trustee's* liability to pay the taxes could not be considered under its "mootness doctrine." Raising that issue was not an "attempt to modify or alter the Plan" and was addressed on the merits by the court of appeals. Pet. App. 6a; 911 F.2d at 1544.

We address the "mootness doctrine" here for two reasons. First, respondents' reliance on that doctrine (which was framed as an attack on this Court's jurisdiction)[43] in opposing certiorari (and presumably to be renewed) fundamentally misconstrues the obligations of the federal courts in implementing the bankruptcy laws and should be rejected. Second, the court of appeals' application of its "mootness doctrine" to preclude the trustee's pursuit of his allegation of fraud is so clearly erroneous that if the Court addresses respondents' reliance on the "mootness doctrine" it will conclude that this aspect of the decision below also must fall.

Respondents claimed in opposing certiorari that the Bank, because of the bankruptcy "mootness doctrine," had succeeded in causing the appointment of a trustee with a permanent exemption from the federal statutes. Why is this? Because, they say, the United States did not perceive that it was the Bank's (undisclosed) intention that the trustee should be exempt from the payment of federal income taxes (and the United States, accordingly, did not object to the Plan), and because the debtors did not happen to have $50 million available to obtain a stay of the consummation of the Bank's "cram-down" Plan. The trustee is thus immunized from his statutory obligation to pay federal taxes, they say, and the Bank is immunized from any challenge by anyone for its actions in connection with the confirmation of this Plan.

This contention should be rejected for at least three reasons. First, it affords bankruptcy creditors and debtors the opportunity to evade all kinds of continuing obligations imposed by law and turns the statutory scheme at issue here on its head. Second, the supposed authority

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[42] The trustee also alleged that the Bank provided him a personal indemnification; the court of appeals did not speak to this allegation.

[43] No argument is made that this case fits within the traditional mootness framework: the controversy between the parties had not been settled or otherwise "mooted" in the usual sense, so as to make further adjudication offend the Article III requirement that the federal courts decide only "Cases" and "Controversies." *See DeFunis* v. *Odegaard*, 416 U.S. 312, 319-20 (1974); *United States* v. *Munsingwear, Inc.*, 340 U.S. 36, 39 (1950). The "usual rule in federal cases . . . that an actual controversy must exist at stages of appellate or certiorari review," *Roe* v. *Wade*, 410 U.S. 113, 125 (1973), is fully met here, and no one could argue otherwise.

Nor is there any argument that Congress, by statute, has expressly precluded the district courts or the courts of appeals from exercising jurisdiction or providing relief in this case. *Cf. Lockerty* v. *Phillips*, 319 U.S. 182, 187-89 (1943); *Ex parte McCardle*, 74 U.S. (7 Wall.) 506, 512-14 (1869).

for this "doctrine" comes not from the Constitution or Congress, but solely from "considerations of finality" that amount to a refusal to decide a case based on nothing more than judicial fiat. Third, while the court of appeals expressly held that its "mootness doctrine" (broad as it is) did not cover the question presented in our Petition, should respondents argue that the Eleventh Circuit's "mootness doctrine" is broad enough to apply to that question, we would urge that the "mootness doctrine" so applied would raise questions of constitutional dimension.

1. *The "Mootness Doctrine" is Inapplicable to the Trustee's Statutory Obligations.*[44]—Acceptance of respondents' remarkable contentions would afford great possibilities in the structuring of plans of reorganization for troubled enterprises. The potentials in the tax area are made obvious by this case. But there is no reason to believe creative bankruptcy lawyers will stop there. Many federal statutory obligations are financially burdensome—but creditors and debtors are not permitted to immunize themselves from these statutes by adopting a plan of reorganization that precludes compliance. Otherwise, companies will begin to adopt plans calling for the non-applicability of costly federal statutes like OSHA, CERCLA, the Clean Air Act, and the Food and Drug Act. There is no distinction between an ongoing duty to comply with these statutes and an ongoing duty to comply with the federal tax laws.

Moreover, respondents' position turns the particular statutory scheme involved here on its head. As the Court explained in *Bull* v. *United States*, 295 U.S. 247, 259-60

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[44] We shall assume, except where otherwise noted, for the purposes of argument, the correctness of the point made by the Bank and apparently by the trustee, in opposing certiorari, that the Plan's failure to provide for the payment of taxes should have been equated with an express provision that the trustee was not liable for the payment of taxes. Of course, we dispute the equivalency of the two concepts.

(1935), because "taxes are the life-blood of the government and their prompt and certain availability an imperious need . . . . the usual procedure for the recovery of debts is reversed in the field of taxation. Payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer." This policy has found expression in section 960 of the Judicial Code, which makes it clear that, as an officer of the court, the trustee must pay taxes on his own initiative. Section 960 prescribes a standard of conduct for the fiduciary, not for the taxing authorities. Similarly I.R.C. § 6012 (b)(3) places the burden on the trustee to file returns, thereby providing the United States with sufficient information to understand the tax liabilities, and requires the trustee to pay the taxes in the ordinary course—in conformity with the federal income tax self-assessment system. A similar obligation is imposed on trustees not appointed by courts. I.R.C. § 6012(b)(4). And 31 U.S.C. § 3713 imposes a similar, absolute obligation on insolvency "representative[s]," under pain of personal liability. These laws simply do not permit the trustee to ignore his legal obligations to the United States—obligations that do not depend in any way on action or inaction by the taxing authorities or the direction in a Plan that he pay—or not pay—taxes.

2. *The Expansion of the "Mootness Doctrine" Suggested by Respondents is Without Statutory Authority.*—Congress has determined that "[t]he courts of appeals shall have jurisdiction of appeals from *all* final decisions, judgments, orders, and decrees" entered in bankruptcy cases. 28 U.S.C. § 158(d) (emphasis added). Section 158 also uses mandatory language in describing the appellate jurisdiction of the district courts and of bankruptcy appellate panels over orders of the bankruptcy courts. 28 U.S.C. § 158(a)-(b).

Thus Congress has established a system that requires: (1) exclusive district court jurisdiction of bankruptcy cases, which are ordinarily referred to the bankruptcy

court;[45] (2) appellate review in the first instance either by a district judge or a bankruptcy appellate panel; and (3) appellate review of *all* cases in the courts of appeals. The mandatory language of the statute ("shall have jurisdiction" over "all" appeals) indicates a clear intent that judicial review should not be precluded except in the most limited circumstances—circumstances that Congress has defined by statute.

There are only two provisions in the Bankruptcy Code precluding appellate review in the absence of a stay: section 363(m) and section 364(e).[46] Under section 363(m), the "validity" of a sale cannot be "affect[ed]" by reversal on appeal if made under authority of section 363(b) by a trustee (or the debtor-in-possession) after notice and a hearing on the proposed sale during the course of the bankruptcy case. The Bank and the court of appeals have both acknowledged that "[s]section 363(m) does not apply . . . [to sales] by a liquidating trustee pursuant to a plan of liquidation." *Miami Center*, 838 F.2d at 1553. In this absence of congressional direction to the contrary, judicial review should not be precluded based on generalized policy considerations of finality.[47]

Absent exceptional circumstances, "the federal courts have a 'virtually unflagging obligation . . . to exercise the jurisdiction given them.'" *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 15 (1983) (quoting

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[45] 28 U.S.C. §§ 157(a), 1334.

[46] Section 364(e)—which relates to authorizations under section 364 to obtain credit or incur debt—is clearly inapplicable to this case even by any form of analogy.

[47] Although some judges and courts have expressed the view that precluding review in cases where sections 363(m) and 364(e) do not apply will enhance the value of bankruptcy estates being liquidated (*see, e.g., In re Joshua Slocum Ltd.*, 922 F.2d 1081, 1095 (3d Cir. 1990) (Sloviter, J., dissenting); *In re Stadium Mgt. Corp.*, 895 F.2d 845, 847 (1st Cir. 1990)), Congress made its view clear that only a limited class of bankruptcy transactions was to be insulated from appellate review. That policy decision must be left with Congress.

Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 817 (1976)); *see England v. Louisiana State Bd. of Medical Examiners*, 375 U.S. 411, 415 (1964); *McClellan v. Carland*, 217 U.S. 268, 282 (1910); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 404 (1821). As Justice Brennan explained in *Colorado River*, "[o]nly the clearest of justifications" warrant a federal court's decision to decline to exercise the jurisdiction provided by Congress. 424 U.S. at 819. Such justifications include, for example, a clear expression of congressional intent that jurisdiction should not be exercised—as in *Colorado River* itself, as well as cases controlled by the language of statutes that preclude judicial review. *E.g., Lockerty v. Phillips*, 319 U.S. at 187-89; *Ex parte McCardle*, 74 U.S. (7 Wall.) at 512-14. Here, however, Congress has expressed its intent that the courts shall exercise jurisdiction over "all" bankruptcy cases, 28 U.S.C. §§ 158(d), 1334, and carved out only two limited exceptions. *See In re Joshua Slocum Ltd.*, 922 F.2d at 1084 ("only two provisions of the Bankruptcy Code . . . specifically require that a party seek a stay pending appeal . . . . We decline to . . . create a third situation where parties are required to seek a stay"); *cf. In re AOV Indus.*, 792 F.2d 1140, 1148 (D.C. Cir. 1986) (application of "mootness doctrine" to reorganization plan inappropriate unless the plan "'has been so far implemented that *it is impossible to fashion effective relief for all concerned*'" (quoting *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (9th Cir. 1981)) (emphasis by the *AOV* court); *Ohio v. Madeline Marie Nursing Homes*, 694 F.2d 449, 463 (6th Cir. 1982) (recognizing inapplicability of "mootness doctrine" where disgorgement or other equitable relief available). Respondents' request that the Court expand the "mootness doctrine" beyond the statutory limits—and beyond the limits placed on it by the court of appeals—would defy congressional intent.

3. *The Eleventh Circuit's Version of the "Mootness Doctrine" Has Led to Erroneous Results and, If Taken to*

the Further Extremes Respondents Suggest, Would Be Unconstitutional.—While the Eleventh Circuit did not go so far as to apply its mootness doctrine to the question whether the trustee was required to file tax returns and pay taxes, if the Court were to find this ruling inconsistent with the Eleventh Circuit's other rulings applying the mootness doctrine in this case, the Eleventh Circuit's enunciation of the "mootness doctrine" should not be accepted as an appropriate standard. The court of appeals' doctrine exemplifies a disturbing misapplication of the bankruptcy laws and violates the constitutional requirement that the essential attributes of judicial power be retained in an Article III court.

The court of appeals declined to consider the trustee's argument that the Bank should be liable because it proposed a plan that did not provide for the payment of taxes. That *issue* was therefore held unreviewable. But a bankruptcy judge may not confirm a plan without adequate investigation into whether federal taxes will be paid. *United States* v. *Energy Resources Co.*, 110 S. Ct. 2139, 2142 (1990) ("The Code . . . requires the bankruptcy court to assure itself that reorganization will succeed, [11 U.S.C.] § 1129(a)(11), and therefore that the IRS, in all likelihood, will collect the tax debt owed."); *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 434-35 (1968) (bankruptcy court must engage in "adequate and intelligent consideration of the merits," not "mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law"; "a plan of reorganization which is unfair to some persons may not be approved by the court even though the vast majority of creditors have approved it"). Here, the bankruptcy judge considered himself "a babe in the woods" without "the foggiest notion" of the tax consequences of the Bank's Plan. *See* pp. 4-5, *supra*. He never received evidence or argument upon the nature and extent of the tax liabilities.[48] If the Bank is correct that its Plan was intended to preclude the trustee from paying the taxes, the Plan should never have been confirmed. *See United States* v. *Key*, 397 U.S. at 326 (under former Chapter X of the Bankruptcy Act, a liquidating plan which ignored the absolute priority of the United States under the predecessor of section 3713 was not "fair and equitable" and could not be confirmed).[49] The trustee correctly says that the Bank should now be held responsible for the "material omission" (J.A. 127) on which the Court and the creditors relied. Doing so will not require creditors who have long since been paid to be hauled back into court. Relief against the trustee by the taxing authorities and by these authorities and the trustee against the Bank will be sufficient. *See In re AOV Indus.*, 792 F.2d at 1149 ("mootness doctrine" unavailable where defendant can "make partial or total restitution . . . to the Debtor's estate"). So far from it being the law that considerations of "mootness" preclude a fiduciary appointed under a plan from protesting that the plan is unlawful if it contravenes the United States' absolute priority, this Court has held that such a fiduciary is expected, even after plan confirmation, to call such a deficiency to the attention of the court. *See King* v. *United States*, 379 U.S. at 339.

Similarly, the court of appeals held that the trustee was not permitted to pursue his allegation that the Bank's Plan was the product of a fraud on the court.

[48] Indeed, the bankruptcy judge suggested only that some kind of "adjustment" might be made to "alleviate adverse tax consequences." Transcript on Motion for Substantive Consolidation (July 18, 1985) (BNY Br. in Opp. B-49). The Judge did not appear to understand that a sale of a property creates capital gains: a "tax consequence" that simply cannot be "alleviate[d]."

[49] Here, of course, the Plan has been held to violate the fair and equitable standard. *See* pp. 4 n.5, 6-7, *supra*.

But the bankruptcy court has the power to investigate such allegations and to fashion appropriate relief accordingly. All federal courts possess an inherent power that, *inter alia*,

> allows a federal court to vacate its own judgment upon proof that a fraud has been perpetrated upon the court. This "historic power of equity to set aside fraudulently begotten judgments," *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U.S. 238, 245 (1944), is necessary to the integrity of the courts, for "tampering with the administration of justice in [this] manner . . . involves far more than an injury to a single litigant. It is a wrong against the institutions set up to protect and safeguard the public." *Id.* at 246.

Chambers v. *NASCO, Inc.*, 111 S. Ct. 2123, 2132 (1991) (citations omitted). While Congress has determined that a court may not "revoke" an order of confirmation for fraud after 180 days have elapsed, 11 U.S.C. § 1144, the inherent power provides substantial alternatives to revocation, including the relief requested by the trustee here—liability of the Bank as the proponent of the Plan.

More fundamentally, the application of the "mootness doctrine" suggested by respondents raises troubling constitutional questions. In essence, respondents seek a judicially created doctrine that effectively precludes Article III scrutiny of bankruptcy judges' decisions. Once a creditor's "cram-down" plan is confirmed, unless the debtors post a bond—and bankruptcy debtors as a class are unlikely to have the wherewithal to do so—the entire case will become "moot" and Article III review improper. If Congress had done explicitly what respondents suggest the courts do, such a statute would have been unconstitutional because the "essential attributes of the judicial power" would not be retained in an Article III court. *See Northern Pipeline Constr. Co.* v. *Marathon Pipe Line Co.*, 458 U.S. 50, 77 (1982) (plurality opinion). Under respondents' theory, bankruptcy judges would confirm

plans without the possibility of any Article III review at all.

III. THE GRANTOR TRUST RULES ARE INAPPLICABLE IN BANKRUPTCY CASES.

In opposing certiorari, respondents asserted that the grantor trust provisions of the Internal Revenue Code, I.R.C. §§ 671 to 679, somehow relieve the trustee of his responsibilities to file federal tax returns and pay federal taxes and instead require the debtors to pay the taxes out of assets not held by the trustee. (Of course, since the trustee asserts that he has possession of *all* the debtors' assets under 11 U.S.C. § 541(a), there are no such assets.) The court of appeals declined to accept respondents' invitation to meld these two distinct statutory schemes in such a novel and self-defeating way; this Court may similarly reject it because the grantor trust provisions simply do not apply in bankruptcy cases.

The grantor trust provisions govern the tax liabilities of grantors of trusts who maintain specified types of dominion and control over the trust's assets. In general, they were enacted to provide express and specific rules for "taxing to the grantor the income of a trust over which he has retained substantial dominion and control," in response to this Court's decision in *Helvering* v. *Clifford*, 309 U.S. 331 (1940). S. Rep. No. 1622, 83d Cong., 2d Sess. 364, *reprinted in* 1954 U.S. Code Cong. & Admin. News 4621, 5005.

Where the grantor's powers come within one of the specific provisions of the grantor trust rules (I.R.C. §§ 673 to 679), the statute provides "there shall then be included in computing the taxable income and credits of the grantor . . . those items of income, deductions, and credits against tax of the trust." I.R.C. § 671. In other words, where the grantor trust rules apply, they require the inclusion of the *trust's* income in the income of the *grantor*.

These provisions were never intended to apply in bankruptcy cases. To apply them here as respondents have

suggested would exempt the trustee from the obligation to pay the taxes when he is the one and only person with the assets to do so. This would be directly contrary to the spirit and purpose of the grantor trust provisions, which were enacted to prevent the maker of a voluntary, donative transfer from escaping taxation on the trust income while retaining dominion and control of the trust. The House Report accompanying the original grantor trust statute[50] explained: "Trusts have been used to evade taxes by means of provisions allowing the distribution of the income to the grantor or its use for his benefit. The purpose of this subdivision of the bill is to stop this evasion." H.R. Rep. No. 179, 68th Cong., 1st Sess. 59, *reprinted in* 1939-1 C. B., Pt. 2, 241, 256. Congress' solution was to require such grantors to include the trusts' income as their own. There is no evidence that Congress ever intended that these rules could actually be used by participants in the bankruptcy process to *escape* the effects of taxation.

The only court of appeals to have addressed the applicability of the grantor trust rules to trusts created in bankruptcy cases has held them unequivocally inapplicable because " 'the very nature of the Bankruptcy Act is inconsistent with the requirements of the Grantor Trust provisions.' " *DePinto* v. *United States*, 585 F.2d 405, 407 (9th Cir. 1978) (citation omitted). In that case, the court examined the legislative history of these provisions and explained:

> One who obtains the protection of the Bankruptcy Act does not make a donative transfer and usually with great regret relinquishes the sort of dominion and control over the bankruptcy estate that Congress perceived to be an essential element of the grantor trust provisions. Nothing in the legislative history of these provisions indicates that Congress intended for

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[50] Revenue Act of 1924, Pub. L. 68-196, § 219(g), 43 Stat. 253, 277.

> them to apply in the case of an individual bankruptcy. We so hold.

585 F.2d at 407 (citations omitted).

As the *DePinto* court recognized, bankruptcy cases simply do not fit within the grantor trust provisions. Indeed, respondents relied for their argument on a single, wrongly decided bankruptcy case, *In re Sonner*, 53 Bankr. 859 (Bankr. E.D. Va. 1985), which Professor King and his colleagues consider "one of the more troubling cases" because it "reaches a harsh result using a strained application of the grantor trust provisions." 1 *Collier on Bankruptcy* ¶ 8.02, at 8-16. Moreover, this trust, created pursuant to a confirmed plan of reorganization, was not the subject of a voluntary, donative transfer of any sort— it was a trust imposed on the debtors by a court over their vehement objection.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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APPENDIX

STATUTORY PROVISIONS INVOLVED

1. Section 960 of Title 28, United States Code, Judiciary and Judicial Procedure, provides:

> **28 U.S.C. § 960. Tax liability**
>
> Any officers and agents conducting any business under authority of a United States court shall be subject to all Federal, State and local taxes applicable to such business to the same extent as if it were conducted by an individual or corporation.

2. Section 6012(b) of the Internal Revenue Code of 1954, as amended, provides in part: [1]

> **26 U.S.C. § 6012. Persons required to make returns of income**
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> * * * *
>
> **(b) Returns made by fiduciaries and receivers.—**
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> * * * *
>
> **(3) Receivers, trustees and assignees for corporations.**—In a case where a receiver, trustee in a case under title 11 of the United States Code, or assignee, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to all or substantially all the property or business of a corporation, whether or not such property or business is being operated, such receiver, trustee, or assignee shall make the return of income for such corporation in the same manner and form as corporations are required to make such returns.

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[1] The present provision of the Internal Revenue Code of 1986, 26 U.S.C. § 6012(b) (1988), is identical.

(4) **Returns of estates and trusts.**—Returns of an estate, a trust, or an estate of an individual under chapter 7 or 11 of title 11 of the United States Code shall be made by the fiduciary thereof.

* * * *

3. Section 6151(a) of the Internal Revenue Code of 1954, as amended, provides:[2]

26 U.S.C. § 6151. Time and place for paying tax shown on returns

(a) General Rule.—Except as otherwise provided in this subchapter, when a return of tax is required under this title or regulations, the person required to make such return shall, without assessment, or notice and demand from the Secretary, pay such tax to the internal revenue officer with whom the return is filed, and shall pay such tax at the time and place fixed for filing the return (determined without regard to any extension of time for filing the return).

4. Section 3713 of Title 31, United States Code, Money and Finance, provides in part:

31 U.S.C. § 3713. Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

[2] The present provision of the Internal Revenue Code of 1986, 26 U.S.C. § 6151(a) (1988), is identical.

(iii) an act of bankruptcy is committed;

* * * *

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the Government.